

(g) [Reserved]

[T.D. 8417, 57 FR 20758, May 15, 1992]

§ 1.469-3T Passive activity credit (temporary).

(a) *Computation of passive activity credit.* The taxpayer's passive activity credit for the taxable year is the amount (if any) by which—

(1) The sum of all of the taxpayer's credits that are subject to section 469 for such year; exceeds

(2) The taxpayer's regular tax liability allocable to all passive activities for such year.

(b) *Credits subject to section 469—(1) In general.* Except as otherwise provided in this paragraph (b), a credit is subject to section 469 for a taxable year if and only if—

(i) Such credit—

(A) Is attributable to such taxable year and arises in connection with the conduct of an activity that is a passive activity for such taxable year; and

(B) Is described in—

(1) Section 38(b) (1) through (5) (relating to general business credits);

(2) Section 27(b) (relating to corporations described in section 936);

(3) Section 28 (relating to clinical testing of certain drugs); or

(4) Section 29 (relating to fuel from nonconventional sources); or

(ii) Such credit is allocable to an activity for such taxable year under § 1.469-1T(f)(4).

(2) *Treatment of credits attributable to qualified progress expenditures.* Any credit attributable to an increase in qualified investment under section 46(d)(1)(A) (relating to qualified progress expenditures) with respect to progress expenditure property (as defined in section 46(d)(2)) is subject to section 469 for a taxable year if—

(i) Such credit is attributable to such taxable year;

(ii) Such credit is described in paragraph (b)(1)(i)(B) of this section; and

(iii) It is reasonable to believe that such progress expenditure property will be used in a passive activity of the taxpayer when it is placed in service.

(3) *Special rule for partners and S corporation shareholders.* The character of a credit of a taxpayer arising in connection with an activity conducted by a partnership or S corporation (as a

credit subject to section 469) shall be determined, in any case in which participation is relevant, by reference to the participation of the taxpayer in such activity. Such participation is determined for the taxable year of the partnership or S corporation (and not the taxable year of the taxpayer). See § 1.469-2T(e)(1).

(4) *Exception for pre-1987 credits.* A credit is not subject to section 469 if it is attributable to a taxable year of the taxpayer beginning prior to January 1, 1987.

(c) *Taxable year to which credit is attributable.* A credit is attributable to the taxable year in which such credit would be (or would have been) allowed if the credits regard to the limitations contained in sections 26(a), 28(d)(2), 29(b)(5), 38(c), and 469.

(d) *Regular tax liability allocable to passive activities—(1) In general.* For purposes of paragraph (a)(2) of this section, the taxpayer's regular tax liability allocable to all passive activities for the taxable year is the excess (if any) of—

(i) The taxpayer's regular tax liability for such taxable year; over

(ii) The amount of such regular tax liability determined by reducing the taxpayer's taxable income for such year by the excess (if any) of the taxpayer's passive activity gross income for such year over the taxpayer's passive activity deductions for such year.

(2) *Regular tax liability.* For purposes of this section, the term "regularly tax liability" has the meaning given such term in section 26(b).

(e) *Coordination with section 38(b).* [Reserved]. See § 1.469-3(e) for rules relating to this paragraph.

(f) *Coordination with section 50.* [Reserved]. See § 1.469-3(f) for rules relating to this paragraph.

(g) *Examples.* The following examples illustrate the application of this section:

Example 1. (i) A, a calendar year individual, is a general partner in calendar year partnership P. P purchases a building in 1987 and, in 1987, 1988, and 1989, incurs rehabilitation costs with respect to the building. The building is placed in service in the rental activity in 1989. P's rehabilitation costs are qualified rehabilitation expenditures (within the meaning of section 48(g)(2)) and are taken into account in determining the amount of

the investment credit for rehabilitation expenditures. P's qualified rehabilitation expenditures are not qualified progress expenditures (within the meaning of section 46(d)).

(ii) Because, under section 46(c)(1), the credit is allowable for the taxable year in which the rehabilitated property is placed in service, the credit allowable for P's qualified rehabilitation expenditures arises in connection with the activity in which the property is placed in service. In addition, the credit is attributable to 1989, the year in which the property is placed in service, because it would be allowed for such year if A's credits allowed for all taxable years were determined without regard to the limitations contained in sections 26(a), 28(d)(2), 29(b)(5), 38(c), and 469. Accordingly, under paragraph (b)(1) of this section, A's distributive share of the credit is subject to section 469 for 1989 because the credit arises in connection with a rental activity for such year.

Example 2. The facts are the same as in Example 1, except that the rehabilitation costs are incurred in anticipation of placing the building in service in a rental activity, the qualified rehabilitation expenditures in 1987 and 1988 are qualified progress expenditures ("QPEs") (within the meaning of section 46(d)(3)), the improvements resulting from the expenditures are progress expenditure property (within the meaning of paragraph (d)(2) of this section), and it is reasonable to expect that such property will be transition property (within the meaning of section 49(e)) when the property is placed in service. Therefore, under section 46(d)(1)(A), the qualified investment for 1987 and 1988 is increased by an amount equal to the aggregate of the applicable percentage of the qualified rehabilitation expenditures incurred in such years. The credits that are based on these expenditures are attributable (under paragraph (c) of this section) to 1987 and 1988, respectively. It is reasonable to believe in 1987 and 1988 that the progress expenditure property will be used in a rental activity when it is placed in service. Accordingly, under paragraph (b)(2) of this section, A's distributive share of the credit for 1987 and 1988 is subject to section 469. Under paragraph (b)(1) of this section (as in Example 1), A's distributive share of the credit for 1989 is also subject to section 469.

Example 3. (i) B, a single individual, acquires an interest in a partnership that, in 1988, rehabilitates a building and places it in service in a trade or business activity in which B does not materially participate. For 1988, B has the following items of gross income, deduction, and credit:

Gross income:

Income other than passive activity gross income	\$110,000	
Passive activity gross income	20,000	\$130,000

Deductions:

Deductions other than passive activity deductions	23,950	
Passive activity deductions	18,000	(41,950)
Taxable income		88,050

Credits:

Rehabilitation credit from the passive activity	8,000
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(ii) For 1988, the amount by which B's passive activity gross income exceeds B's passive activity deductions (B's net passive income) is \$2,000. Under paragraph (d) of this section, B's regular tax liability allocable to passive activities for 1988 is determined as follows:

(A) Taxable income	\$88,050	
(B) Regular tax liability		\$24,578.50
(C) Taxable income minus net passive income	86,050	
(D) Regular tax liability for taxable income of \$86,050.00 ...		23,918.50
(E) Regular tax liability allocable to passive activities ((B) minus (D))		\$660.00

(iii) Under paragraph (a) of this section, B's passive activity credit for 1988 is the amount by which B's credits that are subject to section 469 for 1988 (\$8,000) exceed B's regular tax liability allocable to passive activities for 1988 (\$660.00). Accordingly, B's passive activity credit for 1988 is \$7,340.

Example 4. (i) The facts are the same as in Example 3 except that, in 1988, B also has additional deductions of \$100,000 from a trade or business activity in which B materially participates for 1988. Thus, B has a taxable loss for 1988 of \$11,950, determined as follows:

Gross income:

Income other than passive activity gross income	\$110,000	
Passive activity gross income ..	20,000	\$130,000

Deductions:

Deductions other than passive activity deductions	123,950	
Passive activity deductions	18,000	(141,950)
Taxable income		(11,950)

(ii) Under section 26(b) and paragraph (d)(2) of this section, the regular tax liability for a taxable year cannot exceed the tax imposed by chapter 1 of subtitle A of the Internal Revenue Code for the taxable year. Therefore, under paragraph (d)(1) of this section, B's regular tax liability allocable to passive activities for 1988 is zero. Although B's net operating loss for the taxable year is reduced by B's net passive income, and B's regular tax liability for other taxable years may increase as a result of the reduction, such an increase does not change B's regular tax liability allocable to passive activities for

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1988. Accordingly, B's passive activity credit for 1988 is \$8,000.

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§ 1.469-4 Definition of activity.

(a) *Scope and purpose.* This section sets forth the rules for grouping a taxpayer's trade or business activities and rental activities for purposes of applying the passive activity loss and credit limitation rules of section 469. A taxpayer's activities include those conducted through C corporations that are subject to section 469, S corporations, and partnerships.

(b) *Definitions.* The following definitions apply for purposes of this section—

(1) *Trade or business activities.* Trade or business activities are activities, other than rental activities or activities that are treated under § 1.469-1T(e)(3)(vi)(B) as incidental to an activity of holding property for investment, that—

(i) Involve the conduct of a trade or business (within the meaning of section 162);

(ii) Are conducted in anticipation of the commencement of a trade or business; or

(iii) Involve research or experimental expenditures that are deductible under section 174 (or would be deductible if the taxpayer adopted the method described in section 174(a)).

(2) *Rental activities.* Rental activities are activities that constitute rental activities within the meaning of § 1.469-1T(e)(3).

(c) *General rules for grouping activities—*(1) *Appropriate economic unit.* One or more trade or business activities or rental activities may be treated as a single activity if the activities constitute an appropriate economic unit for the measurement of gain or loss for purposes of section 469.

(2) *Facts and circumstances test.* Except as otherwise provided in this section, whether activities constitute an appropriate economic unit and, therefore, may be treated as a single activity depends upon all the relevant facts and circumstances. A taxpayer may use any reasonable method of applying the relevant facts and circumstances in

grouping activities. The factors listed below, not all of which are necessary for a taxpayer to treat more than one activity as a single activity, are given the greatest weight in determining whether activities constitute an appropriate economic unit for the measurement of gain or loss for purposes of section 469—

(i) Similarities and differences in types of trades or businesses;

(ii) The extent of common control;

(iii) The extent of common ownership;

(iv) Geographical location; and

(v) Interdependencies between or among the activities (for example, the extent to which the activities purchase or sell goods between or among themselves, involve products or services that are normally provided together, have the same customers, have the same employees, or are accounted for with a single set of books and records).

(3) *Examples.* The following examples illustrate the application of this paragraph (c).

Example 1. Taxpayer C has a significant ownership interest in a bakery and a movie theater at a shopping mall in Baltimore and in a bakery and a movie theater in Philadelphia. In this case, after taking into account all the relevant facts and circumstances, there may be more than one reasonable method for grouping C's activities. For instance, depending on the relevant facts and circumstances, the following groupings may or may not be permissible: a single activity; a movie theater activity and a bakery activity; a Baltimore activity and a Philadelphia activity; or four separate activities. Moreover, once C groups these activities into appropriate economic units, paragraph (e) of this section requires C to continue using that grouping in subsequent taxable years unless a material change in the facts and circumstances makes it clearly inappropriate.

Example 2. Taxpayer B, an individual, is a partner in a business that sells non-food items to grocery stores (partnership L). B also is a partner in a partnership that owns and operates a trucking business (partnership Q). The two partnerships are under common control. The predominant portion of Q's business is transporting goods for L, and Q is the only trucking business in which B is involved. Under this section, B appropriately treats L's wholesale activity and Q's trucking activity as a single activity.

(d) *Limitation on grouping certain activities.* The grouping of activities